UNITED NATIONS
ECONOMIC AND SOCIAL COUNCIL

Distr.:
LIMITED

E/ECA/TRADE/88/9
16 May 1988

Original: ENGLISH

ECONOMIC COMMISSION FOR AFRICA

First 1988 Meeting of the Working Party of African Governors in the IMF and World Bank

Gaborone (Botswana), 25-29 July 1988

LC/AM/1988/1

ISSUES FOR THE MEMORANDUM TO THE PRESIDENT OF THE WORLD BANK

I. Introduction

1. A number of disappointments characterized the economic performance during the year 1987 and prospects for 1988 seem to be worse 1/. A recession in 1988 in the major industrial economies will have dire consequences for the African region in terms further reduced resource flows and possibly higher interest rates, which would increase the already heavy debt burden of African countries.

2. The uncertainty over future prices for all commodities also dim the prospects increase in exports earnings and the overall international trade relations of most of the African countries.

II. Resource Flows

3. There is no doubt that the support of the Bretton Woods Institutions, namely the World Bank is indispensable especially in the implementation of Africa's Priority Programme for Economic Recovery (APPER 1986-1990). Bearing in mind the sharp decline in ODA in real terms over recent years, the World Bank ought to undertake special efforts to mobilise more resources on concessional terms for African countries especially the least developed ones. In this context, it should persuade the developed countries to increase the Official Development Assistance to reach the target of 0.7 per cent of GNP as called for in the International Development Strategy for the third United Nations Development Decade. The developed countries should also be urged to honour their commitment to provide 0.15 per cent of their GNP to the Least Developed countries as called for by the Substantial New Programme of Action.

4. Africa should strongly appeal to the World Bank to persuade the industrial countries to take measures designed to encourage their commercial banks to resume and increase their investment and lending to African countries especially during the APPER and UNPAAERD period.

III. The Capital Base of the Bank

5. The resources of the World Bank have become the major funding for development financing in Africa. The need for more resources to implement APPER and UNPAAERD constitutes a strong argument for a substantial increase in the authorized capital of the World Bank with a view to expanding its lending programme in real terms to African countries especially during the period of the programme 1986-1990. African countries have noted with concern that the major donors do not envisage any capital increase in the near future. It is agreed that the World Bank should be urged to persuade the major industrialized countries to reconsider their position in this important matter.

1/ For more details, see E/ECA/CM.14/4: «Survey of Economic and Social Conditions in Africa 1985-1987, pages 17-49.

IV. New financial instruments

6. The pattern of borrowing by African developing countries in the 1970s has revealed the danger of heavy reliance on a single source of credit, especially in the context of fast-changing capital markets. Bank lending has so far transferred most risks to the borrower, including the exchange rate risk, the interest rate risk and especially the risk of mismatch between foreign exchange earnings and debt service obligations. However, this transfer of risks to borrowers has at the same time increased the credit risk to be borne by lenders. The main issue is therefore how new pattern of flows should evolve desirable features of a new pattern of finance that ensures a more balanced risk-sharing between lenders and borrowers; a diversification of sources of finance both to increase the volume of resources and to bring greater stability to the supply of finance, and a better distribution between debt-creating and non-debt-creating instruments, to reduce mismatching of changes in debt-service obligations and in foreign exchange earnings. The new financial instruments should include equity finance, including portfolio investment, bank lending with new modalities, various forms of quasi-equity financing, such as commodity bonds, and variants of project finance such as production-sharing arrangements or improving the traditional financial bodies such as national savings channels.

V. Mobilization of National Savings

7. Developing African countries have a savings potential which existing financial institutions often have not turned to best advantage. Among the principal mechanisms for the mobilization of this potential are contractual savings institutions which can contribute significantly to the allocation of internal resources for economic growth. Such institutions should therefore be back stopped by the World Bank to improve the mobilization of domestic savings and steer them towards development financing. This can be achieved through a combination of the following means: (i) improving the functioning of traditional financial bodies and supporting the criterion of new and innovative ones such as credit dispensing and savings collecting institutions, commercial banks, national development banks; (ii) establishing links between formal and informal savings mobilization circuits; (iii) offering a wider and more adapted range of savings opportunities to the population; and (iv) seeking better linkages between the savings mobilized and the credit function, with special efforts to use savings locally.

8. The World Bank should in this respect by emphasizing in the course of its normal operations those programmes and projects which result in the mobilization of domestic resources and their compiling with external funds. This may be achieved by measures such as the following: (i) inducing flows of previously untapped local savings in those countries which benefit from technical assistance and loans so as to maximize the savings generation effect of the development finance to which these multinational institutions contribute; (ii) promoting the modernisation of financial markets in developing African countries, both directly through equity investments in local companies and indirectly by fostering policy measures leading to the same overall objective. In doing so, special attention must be focused on: (i) the use of local counterpart financing which is genuinely derived from domestic savings and not from mere

monetary creation or loans from other sources; (ii) the maintenance of an acceptable ratio of local savings to external resources, adjusted to the specific requirements of each country and sector; (iii) an increase in the proportion of loans granted to medium- and small-scale enterprises or small-scale projects so as to favour the generation of local savings; (iv) the adoption of policy measures and reforms in national financial systems which would result in the modernization of capital markets and of financial intermediaries.

VI. The Debt's Strategy

9. Over the past ten years, there has been a dramatic increase in the total debt of African countries as well as the debt servicing obligations. The problem of external debt arises from three main factors: decline in foreign exchange earnings due in a fall in prices of commodities; the decline in the inflow of development financing; and the mounting debt service obligations. According to calculations by ECA secretariat, the trade balance switched from a surplus of $5.9 billion in 1985 to a deficit of $7.5 billion in 1986 and is estimated to be US$7.3 billion in 1988. The current-account deficit reached $21.5 billion, and calculations for 1988 estimate it at US$18.2 billion a much worse result than that was anticipated. There was a further accumulation of payments arrears. Total debt reached $200 billion by the end of 1986 amounting to 66 per cent of GNP and more than 200 per cent of export earnings. The average debt service ratio is now about 35 per cent compared to 7.5 per cent ten years earlier. In a quarter of African countries, this ratio exceeds 50 per cent, and reaches unsustainable levels of 100 per cent or more in some cases. Interest payments amounted to 14 per cent of exports. Net financial flows to sub-Saharan Africa had already been cut by half between 1981 and 1984 and continue their decline.

10. External resource flows in 1986 amounted to only US$18 billion including debt cancellation and rescheduling which showed a decline of 60 per cent of the 1981 level. Estimates by the IMF show that Africa's external debt has reached US$220 billion in 1987 and debt service amounted to US$27 billion. Projections, based on the continuation of the current trend, indicate that unless some urgent measures are taken to deal with the African debt issue, by 1995 the total debt will have reached US$313 billion, with annual debt service payments of US$31 billion. Looking further into the future, it is estimated that by the year 2000, the situation will even be more serious and the total debt (both short and long term) will reach about US$550 billion while annual debt service payments will exceed US$46 billion.

11. The Third Extraordinary Assembly of African Heads of State and Government held in Addis Ababa, Ethiopia, from 30 November to 1 December 1987, reviewed in detail, the deterioration in Africa's external debt situation and the excessive external debt servicing obligations of many African countries. They expressed deep concern that despite their individual efforts to resolve the crisis and despite the repeated appeals to the international community during the preceeding three years, no concrete and lasting solutions have been implemented to alleviate the debt crisis. They unanimously agreed that unless urgent action is taken, the external debt crisis will not only intensify, but will also seriously

jeopardize the very foundation for Africa's economic recovery and self-sustained growth. As a means of addressing the debt crisis the African Heads of State and Government adopted the African Common Position on Africa's External Debt Crisis and concluded that «a lasting solution to the external debt problem of developing countries can only be found within the framework of comprehensive and parallel actions in the major economic sectors, in recognition of the interdependence among the external debt issues, flow of development assistance, improved international trading system, improved commodity prices and the reform of the international monetary system».

12. The World Bank should therefore consider providing debt relief measures of its own loans especially for the least developed (low income) countries in order to alleviate their debt service obligations. In addition, the World Bank should also urge creditor countries and commercial banks to improve the terms of rescheduling by extending repayment, grace and consolidation periods. The conversion of a substantial part of LDCs Debt into grants or equity ought also to be part of the World Bank's strategy aimed at solving Africa's external debt crisis.